

spread only over the number of years the lease has to run without taking into account any right of renewal. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). A subsidiary corporation leases land from its parent at a fair rental for a 25-year period. The subsidiary erects on the land valuable factory buildings having an estimated useful life of 50 years. These facts show with reasonable certainty that the lease will be renewed, even though the lease contains no option of renewal. Therefore, the cost of the buildings shall be depreciated over the estimated useful life of the buildings in accordance with section 167 and the regulations thereunder.

Example (2). A retail merchandising corporation leases land at a fair rental from an unrelated lessor for the longest period that the lessor is willing to lease the land (30 years). The lessee erects on the land a department store having an estimated useful life of 40 years. These facts do not show with reasonable certainty that the lease will be renewed. Therefore, the cost of the building shall be spread over the remaining term of the lease. An annual deduction may be made of an amount equal to the cost of the building divided by the number of years remaining in the term of the lease, and such deduction shall be in lieu of a deduction for depreciation.

(3) See section 178 and the regulations thereunder for rules governing the effect to be given renewal options where a lessee begins improvements on leased property after July 28, 1958, other than improvements which on such date and at all times thereafter, the lessee was under a binding legal obligation to make.

[T.D. 6520, 25 FR 13692, Dec. 24, 1960; as amended by T.D. 8867, 65 FR 3825, Jan. 25, 2000]

§ 1.162-12 Expenses of farmers.

(a) *Farms engaged in for profit.* A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be deducted. The purchase of feed and other costs connected with raising livestock may be treated as expense deductions insofar as such costs represent actual outlay, but not including the value of farm produce

grown upon the farm or the labor of the taxpayer. For rules regarding the capitalization of expenses of producing property in the trade or business of farming, see section 263A and the regulations thereunder. For taxable years beginning after July 12, 1972, where a farmer is engaged in producing crops and the process of gathering and disposal of such crops is not completed within the taxable year in which such crops were planted, expenses deducted may, with the consent of the Commissioner (see section 446 and the regulations thereunder), be determined upon the crop method, and such deductions must be taken in the taxable year in which the gross income from the crop has been realized. For taxable years beginning on or before July 12, 1972, where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may, with the consent of the Commissioner (see section 446 and the regulations thereunder), be determined upon the crop method, and such deductions must be taken in the taxable year in which the gross income from the crop has been realized. If a farmer does not compute income upon the crop method, the cost of seeds and young plants which are purchased for further development and cultivation prior to sale in later years may be deducted as an expense for the year of purchase, provided the farmer follows a consistent practice of deducting such costs as an expense from year to year. The preceding sentence does not apply to the cost of seeds and young plants connected with the planting of timber (see section 611 and the regulations thereunder). For rules regarding the capitalization of expenses of producing property in the trade or business of farming, see section 263A of the Internal Revenue Code and § 1.263A-4. The cost of farm machinery, equipment, and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may, at the election of the taxpayer, be regarded as investments of capital. For the treatment of soil and

water conservation expenditures as expenses which are not chargeable to capital account, see section 175 and the regulations thereunder. For taxable years beginning after December 31, 1959, in the case of expenditures paid or incurred by farmers for fertilizer, lime, etc., see section 180 and the regulations thereunder. Amounts expended in purchasing work, breeding, dairy, or sporting animals are regarded as investments of capital, and shall be depreciated unless such animals are included in an inventory in accordance with § 1.61-4. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but is regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense.

(b) *Farms not engaged in for profit; taxable years beginning before January 1, 1970*—(1) *In general.* If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of farm products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions.

(2) *Effective date.* The provisions of this paragraph shall apply with respect to taxable years beginning before January 1, 1970.

(3) *Cross reference.* For provisions relating to activities not engaged in for profit, applicable to taxable years beginning after December 31, 1969, see section 183 and the regulations thereunder.

[T.D. 7198, 37 FR 13679, July 13, 1972, as amended by T.D. 8729, 62 FR 44546, Aug. 22, 1997; T.D. 8897, 65 FR 50643, Aug. 21, 2000]

§ 1.162-13 Depositors' guaranty fund.

Banking corporations which pursuant to the laws of the State in which they are doing business are required to set apart, keep, and maintain in their banks the amount levied and assessed against them by the State authorities as a "Depositors' guaranty fund," may deduct from their gross income the amount so set apart each year to this fund provided that such fund, when set aside and carried to the credit of the State banking board or duly authorized State officer, ceases to be an asset of the bank and may be withdrawn in whole or in part upon demand by such board or State officer to meet the needs of these officers in reimbursing depositors in insolvent banks, and provided further that no portion of the amount thus set aside and credited is returnable under the laws of the State to the assets of the banking corporation. If, however, such amount is simply set up on the books of the bank as a reserve to meet a contingent liability and remains an asset of the bank, it will not be deductible except as it is actually paid out as required by law and upon demand of the proper State officers.

§ 1.162-14 Expenditures for advertising or promotion of good will.

A corporation which has, for the purpose of computing its excess profits tax credit under Subchapter E, Chapter 2, or Subchapter D, Chapter 1 of the Internal Revenue Code of 1939, elected under section 733 or section 451 (applicable to the excess profits tax imposed by Subchapter E of Chapter 2, and Subchapter D of Chapter 1, respectively) to charge to capital account for taxable years in its base period expenditures for advertising or the promotion of good will which may be regarded as capital investments, may not deduct similar expenditures for the taxable year. See section 263(b). Such a taxpayer has the burden of proving that expenditures for advertising or the promotion of good will which it seeks to deduct in the taxable year may not be regarded as capital investments under the provisions of the regulations prescribed under section 733 or section 451 of the Internal Revenue Code of 1939.